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### LIQUIDATION WATERFALL: NCLAT RULES AGAINST INCLUSION OF SOCIAL SECURITY DUES UNDER 'WORKMEN'S DUES'

27 August 2019

In *State Bank of India v Moser Baer Karamchari Union* [Company Appeal (AT) (Insolvency) Number 396 of 2019] ([Moser Baer](#)), the National Company Law Appellate Tribunal, New Delhi (NCLAT), ruled on the scope of 'workmen's dues' under Section 53 of the Insolvency and Bankruptcy Code, 2016 (IBC) from the perspective of the dues of an employer towards provident fund, pension fund and gratuity.

#### Background

Section 53 of the IBC creates a waterfall mechanism, whereby the proceeds from the sale of the liquidation assets in respect of a corporate debtor are required to be distributed in a certain order of priority. Topping the list are the costs associated with insolvency resolution process and liquidation, which are followed by workmen's dues during the 24 months preceding the liquidation commencement date and debts owed to secured creditor(s), both ranking equally. Interestingly, like labour laws, the IBC distinguishes between workmen and employees, such that the dues in relation to employees (that is, persons not falling in the category of 'workman' under the Industrial Disputes Act 1947) are placed at a lower pedestal than the dues in relation to workmen.

A potential area of ambiguity in the IBC is the connotation of the term 'workmen's dues' as used in Section 53. The Explanation to Section 53 states that the term shall have the same meaning as the one assigned to it under Section 326 of the Companies Act, 2013 (Companies Act). Section 326 includes, within the scope of workmen's dues, almost all kinds of payments due to workmen including sums due in respect of provident fund, pension fund, gratuity or any other fund maintained by the employer for the benefit of the workmen. Therefore, if one were to rely on the Explanation to Section 53, one may infer that social security dues, being workmen's dues, fall within the scope of the waterfall provision.

It is on this basis that the liquidator assigned in respect of the liquidation of Moser Baer India Limited (Corporate Debtor) denied payment of gratuity and social security dues preferentially to workmen and included these items in the waterfall mechanism. The National Company Law Tribunal - Principal Bench, New Delhi (NCLT), upon admitting an application filed by Moser Baer Karamchari Union, ordered the liquidator to exclude the said payments, meaning that it would be the responsibility of the liquidator to ensure that there is requisite fund to take care of any contribution that was required to be remitted to the provident / pension fund. This led State Bank of India, one of the secured creditors of the Corporate Debtor, to file an appeal before the NCLAT.

## NCLAT's Clarification

The NCLAT accepted the contention of the respondents that gratuity and social security dues cannot be made part of the waterfall mechanism by virtue of Section 36 of the IBC. The said provision requires the liquidator to form an estate of the assets of the corporate debtor. It then excludes, from the scope of liquidation estate assets, all sums due to *any workman or employee* in relation to provident fund, pension fund and gratuity fund, such that these sums will not be used for recovery in liquidation.

Placing reliance on Section 36, the NCLAT ruled in favour of a harmonious approach to interpreting 'workmen's dues' under Section 53 and reiterated the NCLT's finding that the question of distribution of social security dues and gratuity amounts in the prescribed order of priority does not arise. The appellate tribunal further explained that it may not be appropriate to place a complete reliance on Section 326 of the Companies Act in this regard, for the purpose of the said provision is to give priority to certain amounts at the time of payment of debts; Section 53, on the other hand, deals with distribution of proceeds from the sale of liquidation assets. Therefore, while the provision may be relied upon for the "limited purpose" of understanding what 'workmen's dues' typically entails, one should read the provisions of Section 36 and Section 53 of the IBC together to ascertain how such dues ought to be treated.

## Comments

The judgment comes after Moser Baer Karamchari Union filed a writ petition before the Supreme Court of India challenging the constitutional validity of Section 327(7) of the Companies Act, which bars the applicability of Sections 326 and 327 thereof to any liquidation under the IBC. It may be noted that Section 326 read with Section 327 of the Companies Act gives priority to workmen's dues over all other debts of the company in the event of winding up. While the fate of the petition is yet to be seen, the NCLAT ruling in *Moser Baer* gives some respite to both workmen and employees by upholding their right to social security as sacrosanct.

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